

Global Securities Finance *Market Monitor*

Issue 39, for the Month Ending July 31, 2005

>> Money Markets Recap

The month began with a new federal funds target rate of 3.25% thanks to a 25 basis point increase implemented by the FOMC on June 30, 2005. This represented the 9th consecutive increase of 25 basis points in a period of exactly one year, and all indications and expectations continue to be for more of the same. Initially, month end pressures kept overnight rates about 10 basis points above the new target, but shortly after the July 4th holiday weekend, those pressures subsided and the overnight rate traded within a few points of the target, ending the month of July with an average of 3.243%. Overnight general collateral U.S. Treasury repo/loans continued to trade a few points below the federal funds rate. The average general collateral repo rate for the month was 3.208%. We look for this spread below funds to continue at least through the mid August refunding period, and perhaps for even some time after that. This factor continues to provide ample spread opportunity in the securities lending portfolios. It appears as though medium and longer term yields are now clearly on the rise, as inflation pressures seem to be getting more and more attention. The yield on the 2 year U.S. Treasury note increased to close the month above the 4.00% level, and will likely trade in a new range of 3.90% to 4.15% until breaking out and moving higher. The bellwether 10 year note also rose in yield to above 4.25% and should continue to find its way towards 4.50% and higher in the near future. Energy prices continue to dominate the volatility in both the fixed income and equities markets, although the economy so far does not show signs of being hindered by the higher price of crude oil. The housing market also continues to attract attention, although there has been no change of view by the policy makers that it does not pose a threat to the economy or banking system. The federal funds futures market has priced in 100% probabilities of a 25 basis point increase at both the August 9 and September 20 FOMC meetings. It splits the increase to 4.25% between late this year or early next. We will continue to watch for any signs of change in market consensus and adjust our strategies accordingly.

>> Securities Lending Market Update

Record utilizations continued to buoy securities lenders in July, as loan volumes maintained very high levels, even during the traditionally quiet summer period. Although borrowers returned non-U.S. equities to beneficial owners, the stability of fixed income balances maintained program earnings. This resulted in volatility only half that of last summer, and helped to maintain predictable collateral balances for cash managers. Borrowers returned younger loans, resulting in average tenure rising by 10%. High loan volumes coupled with market stability and increasing tenure provide an environment for strong lender performance this summer.

Utilizations remained elevated, despite the fact that securities loan balances of institutional investors slid 2.3% in July. Much of the decline was seasonal, following the spring dividend season for cross-border loans to tax arbitrageurs. The drop in equity loans was cushioned by a modest expansion in loans of fixed income securities. While higher interest rates have opened up some opportunities for cash managers to distinguish program earnings, reinvestment rates still showed little variation by sector, but more by type of lender, ranging from banks, 3.23%, to public funds, 3.35%. There was far more variation among distinct lending portfolios.

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